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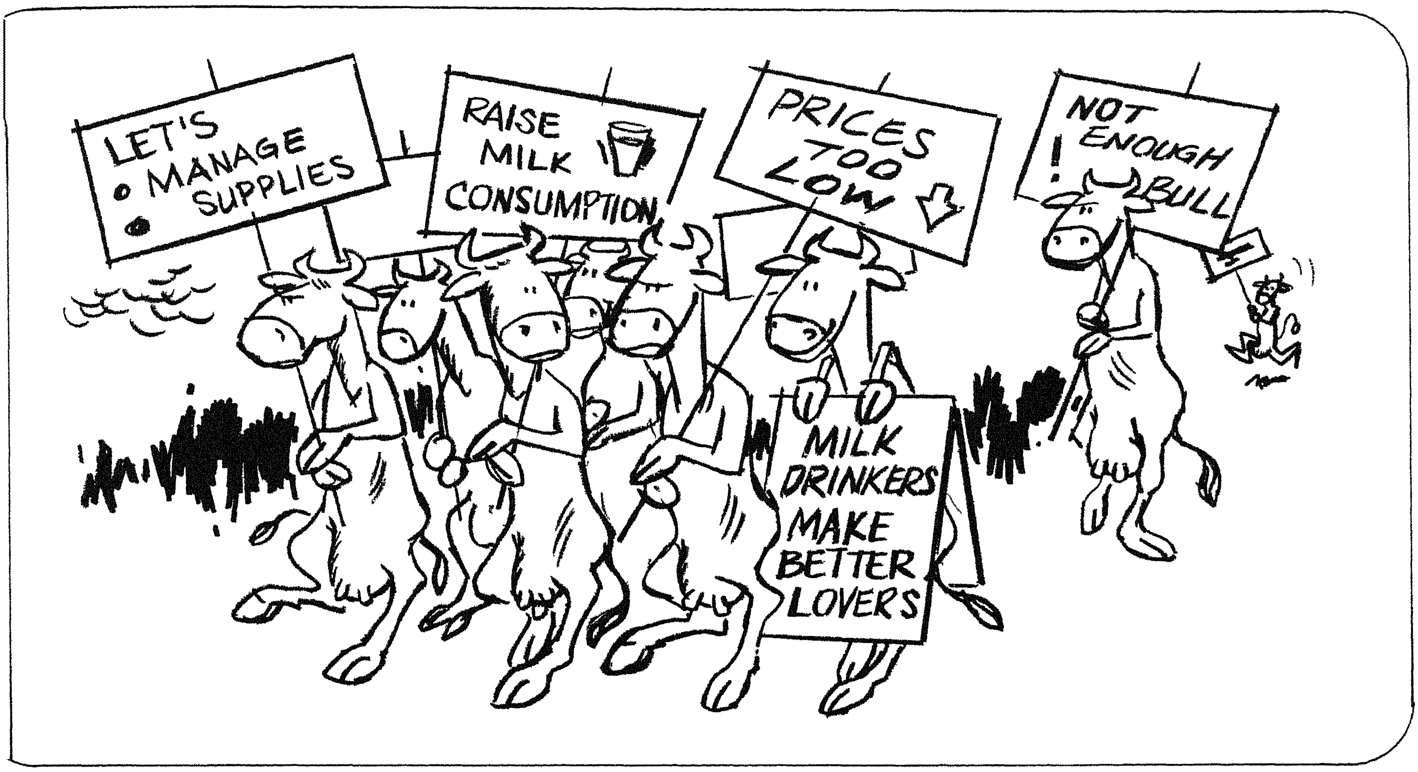

PROCEEDINGS OF A SEMINAR ON

CURRENT PROBLEMS IN THE MILK INDUSTRY

COOPERATIVE EXTENSION SERVICE
THE OHIO STATE UNIVERSITY

MARCH 1973

FOREWORD

Presentations included in these proceedings represent most of the formal part of the program of the seventh Ohio Dairy Seminar, held October 5-6, 1972. This seminar has been sponsored jointly by the Ohio Milk Producers Federation and the Ohio Farm Bureau Federation, in cooperation with the Department of Agricultural Economics and Rural Sociology, the Ohio State University.

The seminar has two basic objectives:

1. To develop fuller communications between the Ohio Milk Producers Federation and the Ohio Farm Bureau Federation on the marketing-policy issues confronting the dairy industry.

2. To discuss and analyze the major priority problem areas in the dairy industry that producer organizations must contend with.

Current problems in the milk industry were emphasized in this seminar, including bargaining problems in the industry, status of advertising-promotion programs, milk pricing policy, and supply management issues. Various viewpoints were presented at the seminar and are included in the proceedings. Opinions are those of the participants and are not necessarily endorsed by the Ohio State University.

The Planning Committee for this seventh seminar in the series included Sam Cashman and William McNutt, Ohio Farm Bureau Federation; Glen Wagner, Donald Zehr, Robert Hester, and Norm Alger, Ohio Milk Producers Federation; and David Hahn and Robert Jacobson, The Ohio State University.

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IS U.D.I.A. AN IMPROVEMENT OVER THE OLD WAY?

Earl Poling
General Manager
American Dairy Association of Ohio

In looking at the topic assigned to me, it will seem most simple to say yes or no, or I don't know. However, it seems that the subject needs a little more consideration. Perhaps at this stage of the game it is impossible to give a definite answer, and each person or group of persons may arrive at various answers, depending on their particular interest.

However, in attempting to arrive at some sort of a logical conclusion, it seems that in a brief fashion we should consider:

1. What is the old way -- what do we mean?

2. What do we mean by improvement -- improvement in:

    a. more funds
    b. more coordination of programs
    c. better accountability
    d. more centralized authority in making decisions -- if so, at what level -- national, state, or other?

3. Why was U.D.I.A. formed?

In reviewing the "old way" it seems most logical to relate procedures used in the A.D.A. and N.D.C. program.

From approximately 1940 to July 1, 1971, funds invested by producers for these two programs were invested in and accounted for through the American Dairy Association of a particular state or region, such as Ohio, Michigan, or the Atlantic area, which comprised several states. The state had a membership agreement with American Dairy Association, and A.D.A. had the responsibility of developing a program.

As you know, the funds were used to develop certain advertising and sales programs. In addition, certain funds were allocated for research and to the National Dairy Council.

During this period, N.D.C. was not to contact producers for funds. Local Dairy Council units still had to solicit funds from producers. In general, the amount allocated to N.D.C. was an amount equal to that invested by handlers and equipment manufacturers.

As you can see, American Dairy Association and the state organizations were performing, to a certain degree, the function of a U.D.I.A. I am sure most producers did not quite understand this arrangement.

This arrangement seemed to work with a fair degree of success. However, it didn't achieve some things:

1. It didn't get programs coordinated.

2. It didn't bring the local dairy council units into the picture, either as to program coordination, or for financing. And, in some areas of the country, this apparently was a problem.

Point No. 2. What are we talking about in referring to U.D.I.A.? Briefly, are we talking about a national program, or are we talking about a U.D.I.A. that includes all levels, or all levels at some degree? In view of trends of organizational structure in some areas, the question seems appropriate. Also, the trends in marketing and market areas make the consideration all the more important.

Point No. 3. Why was U.D.I.A. formed? As is often the case, it is impossible to state the exact time and place, or the individuals who formed the U.D.I.A. It is fair to say that for many years certain people had the idea of some sort of organization that would bring N.D.C. and A.D.A. closer together, and with the formation of DRINC, these same people would no doubt include the research efforts.

In addition to the long-time efforts to better coordinate the programs of A.D.A. and N.D.C., another set of factors were introduced with the formation of larger cooperatives. These organizations were then operating over a much larger geographical area and more important, are investing more money, both per hundredweight and total dollars. Consequently, they demanded:

1. more accountability,
2. more coordinated programs, and
3. better programs.

Time does not permit the relating of all the steps that lead up to the formation of U.D.I.A. It does seem fair to say that U.D.I.A. grew out of an attempt to merge N.D.C. and A.D.A. As a result of this attempt, a study was made which said that an organization should be formed to provide financing of the two efforts, keeping the two programs separate.

Thus, U.D.I.A. was formed on June 9, 1970, with bylaw changes made on September 29 and November 19, 1970. Glen Lake was named president.

This organization provided that A.D.A. and N.D.C. would each have nine members on the Board of Directors, and DRINC, five.

With the exception of Michigan Milk, the organization had few, if any, takers. The principle reason offered was the structure of the organization.

Consequently, the efforts of those who had felt strongly about some of these things seemed to be doomed for failure.

However, in April, 1971, certain people came forth with a revised version of U.D.I.A. This plan, briefly --

1. Placed U.D.I.A. under a producer Board and Executive Committee with rather broad powers,

2. Representation according to total dollars invested in promotion work.

3. Boards of N.D.C. - A.D.A. to come from the U.D.I.A. Board.

It is significant that the chief officers in the major cooperatives endorsed this revision. They said, in effect, "This type of organization best fits the present situation, and we will raise the money to do the job." Consequently, on July 15, 1971, the present organization was adopted.

This is the history, briefly, and where we are today.

Also, it should be noted that many areas of the country are streamlining or revising their state or regional organization in regard to the fund raising, producer accountability, and probably most important, program execution and coordination.

Without taking any time to explain, I refer to:

1. A.D.A. - N.D.C. of New York,
2. Milk promotional services in the Northeast,
3. S.U.D.I.A.
4. Midland U.D.I.A. - Iowa, Nebraska, Kansas, and Missouri
5. South Dakota and Arizona

Ohio, or Ohio and some surrounding territory, seems to be a fairly well contained unit, both in production and markets. I would suggest that we take a look at these areas just mentioned. No doubt we may need some changes and these areas may provide some valuable points.

Where are we nationally? No doubt some things have been accomplished. Example:

1. Meeting together,
2. Same advertising agency

However, the changes and adjustments to be made for U.D.I.A. to work seem to be coming along slow. Some organizations and people seem to have difficulty adjusting to such a setup.

The U.D.I.A. concept calls for:

1. More funds and a total program for all dairy products,
2. More program coordination,
3. Probably more centralization of program planning,
4. Programs to reduce administrative costs.

The use of Federal Orders and the producer agencies to handle the funds create another dimension. The Boards of the cooperatives in most cases have had first supervision of the funds raised from producers for promotional work. It seems that this function has or is being transferred to the so-called agencies.

It appears that the trend has been for agencies to follow the U.D.I.A. concept and allocate funds for existing programs, rather than create new ones. If this concept is followed in the future by present and new agencies, then the use of Federal Orders to create funds can be a useful tool.

However, if each agency wants to become a promotional expert, with an advertising agency, staff of people, etc., then more may be lost than gained for a united program.

To develop some guidelines for program allocations for 1973, a study was authorized and made by a management firm, Booz, Allen, Hamilton & Co. The study is long and detailed, but in principle contains a great deal of valuable information and guidelines. Some specific items may need more study.

One area that is stressed is the organizational structure of U.D.I.A. The authority to bring about some of the changes needed seems to be lacking, according to Booz, Allen, Hamilton. In addition, it seems that other problems facing U.D.I.A. are:

The BAH study did offer suggestions for improvement in current programs. Also, criticisms were directed at certain programs.

Is U.D.I.A. an improvement? In the short run, improvements may be hard to find. Ohio dollars are going to U.D.I.A. to support A.D.A., N.D.C., and DRINC. With more dollars going to N.D.C., naturally less is available for other programs.

In the long run, it does seem that U.D.I.A. can be an improvement. It can be the vehicle to bring changes -- bring in more funds, more coordination of programs, and better execution of these programs.

In summary, perhaps U.D.I.A. hasn't quite achieved to date all that was hoped for. But progress is on the way. Changes have to be made and will be made.

Some years ago I heard a highly successful football coach say that it didn't matter to him whether a boy was big or little. It wasn't his size that made him good or poor, <u>but what was in his heart that counted</u>. That may be the key to making U.D.I.A. what it is meant to be.

Yes, dairy promotion can be better with U.D.I.A., and all this implies at any level. The technical aspects and programs will be worked out if those in command have their hearts and attitudes in the right place, and want to build a united sales program for the dairy industry.

In conclusion, the following quotation from Glenn Lake seems appropriate. In a booklet issued in December, 1970, on "Why U.D.I.A.?", Mr. Lake stated as follows:

"The dairy industry has been out-done, out-maneuvered, and out-distanced by other food competitors. Coca-Cola alone puts more money in promotion each year than the entire dairy industry. As we look to the future, population experts say we should gain about 30 million potential customers in the next ten years. Our job is to get these new customers to use dairy products.

"There is a very real opportunity to increase our selling efforts through expanded and coordinated programs of A.D.A, N.D.C., and DRINC and their affiliates. For the first time in history we have a chance to build an industry-wide effort through the United Dairy Industry Association. Those of us who are working with it are dedicated to its success. The impossible has been achieved. Now it must succeed."

The preceding observations indicate that some adjustments in the structure and staffing of U.D.I.A. are needed if the organization is to effectively fulfill its mission of building the market for dairy products. The principal requirements which should be met in adjusting the organization include the following:

- Bring the four organizations closer together physically and from a management standpoint.

- Eliminate unnecessary duplication of effort and cost.

- Clarify the role of the chief executive of U.D.I.A.

- Provide clear management responsibility and authority to achieve coordination in program planning and execution at all levels of the organization.

- Provide appropriate staff resources, particularly in the marketing area.

- Clarify the responsibilities of and relations between the national and local units.

Because of the importance of organization structure and staffing to the programming efforts, it is recommended that U.D.I.A. give highest priority to the issues discussed in this chapter. If the organization is solid, the programs will follow. If the organization is weak, the likelihood of program success is minimal.

THE COURT SCENE IN FARM BARGAINING AND FARMER COOPERATIVES

Glen Wagner
Legal Counsel
Ohio Milk Producers Federation

I want to review the development in certain court cases over the last year. First, those dealing with the anti-trust law which I consider the most important aspect as far as legal problems with cooperatives are concerned; second, the Federal order cases; and finally, a reference to the Agricultural Fair Practices Act.

I think by all odds the most important development of the last year has been the indictment by the Justice Department against Associated Milk Producers, Inc., filed in the District Court in San Antonio, Texas. The indictment in this instance charged AMPI with certain predatory practices that certainly, if true as alleged, would raise questions as to their legality. Included, however, in some of the charges and explanation in the indictment are other phases of marketing milk that raise serious questions as to whether normal practices carried on by an association and acting on behalf of its members may not be chilled or banned, if final settlement in this case goes as far as apparently is sought by Justice.

In the case of this particular association, the largest dairy cooperative in the U. S., there are many private treble damage suits that are pending and more are being filed.

The reference to this indictment, which will be expanded later in these proceedings, involved practices such as loading the pool, buying routes that are serving non-members, and then discountinuing these routes, and certain practices dealing with processors and their re-sale of products. I would hope that whatever consent degree is arrived will be confined to what we all generally agree are predatory practices, things that we know have been illegal and should be banned; practices, for instance, that were proven to be illegal in the old cranberry cases; principles established, for instance, in the Maryland and Virginia case; things that don't inhibit or prevent a cooperative from properly serving its members. I think if Justice isn't sophisticated enough to know, at least parties in the field know there is a lot of activity in the market place that can be misconstrued if it isn't examined in the light of its bearing on the various parties.

Another case I refer to in the anti-trust field is the litigation going on in Kansas City, initially between Mid-America and the NFO, later expanded to include the Associated Reserve Standby Pool Cooperative and AMPI and other private groups related to them. Some months ago, Mid-America filed its fifth amended complaint and expanded the litigation well beyond the scope it had before. In that complaint they raised questions about governmental decisions on NFO made by the Department of Agriculture and the Internal Revenue Service. These are somewhat complex, but they involve, among other things, the issue as to whether a non-profit organization maintaining that it is not marketing and is therefore entitled to a certain exemption under a certain portion of the IRS code, can then be qualified by the Department of Agriculture as a 'qualified' association under the Federal Milk Order system, and therein maintain that it is marketing milk on behalf of its members. Both apparently contradictory positions require a decision and a finding by the governmental agency. I would suspect that the agency that is more likely to review its findings and do some revising will be the Internal Revenue Service. If anyone is interested in discussing that we can get into it, since it does raise some questions about activities of organizations and how they are organized. It might also have some relation to bargaining, as was mentioned by previous speakers, where you would still be accorded the status of a bargaining cooperative, even though engaged in processing.

Finally, a short comment on the cases that caused a good deal of concern or attention some years ago and are now pretty well down the road. These cases were in Western Pennsylvania. One case, known as Hayes vs. DCSA, was a case where a so-called rump group brought a suit against one of the main cooperatives in the market in Western Pennsylvania. They brought a class action claiming the marketing system and arrangements were in violation of the state law, with interstate shipment constituting some kind of conspiracy. This case was settled quite a while ago and the defendant cooperative made no settlement and paid no money, but under the guidance of the court some of the dealers had to come up with a small amount of money to pay plaintiff costs and get rid of the case. The court, I believe, had indicated that they didn't think that there was any anti-trust law violation involved here.

The most interesting case, however, was the Erie-Crawford Case, known as the Knuth Case. Again, in this case, the rump group brought suit trying to establish a class action against the cooperative. In this case, there were actual rebates or paybacks, or whatever you call them, made by the cooperative in order to meet competition from out-of-state sellers who were apparently free to sell at a lower price. The District Court first dismissed this case. It was reinstated by the Federal Circuit Court of Appeals in Philadelphia and went back for trial in the District Court. The jury decided against the defendant cooperative, on the conversion of money theory, as far as the rebates were concerned, and the Court held that there was no anti-trust violation and no inhibition of competition and, in fact, held to the contrary. Then the case was again appealed to the Circuit Court in Philadelphia and we had a very interesting reversal. The reversal was unanimous and held that the Court erred in several ways in allowing the action; and that they could not prevail on the theory that there being, on the one hand, no anti-trust violation when the conversion of money did occur. The cooperative was converting money that came into its hands in terms of giving certain rebates. The Court of Appeals held that the evidence had to show that the cooperative could have sold the milk for more money than it actually did. Of course, the evidence in the case was that the cooperative could not have sold for more money and that in some cases they paid as much or more than the competitive price in the area even though they gave a rebate. Evidence established that, for instance, New York cooperatives sold milk as cheap or cheaper than Erie cooperatives. But I think the most interesting aspect of that case and the one we will remember after we have forgotten everything else is the dissent or what I call the concurring dissent by one of the three judges that went along with everything that was said and then added another comment. He said, "This is a misconceived class action and I cannot understand how the court ever granted a class action status to the plaintiff farmers who were members of the cooperative." He said, "A class action has to be brought on behalf of everyone in the class against some defendant, but not against members of the same class." In this case, of course, if they ever recover any money, the plaintiff class would recover against the same class, in this case against their own cooperative. I think this was something the lawyers tried to get into the case in the beginning but failed. I think that principle is something that might point the way in the future. That as far as members of cooperatives bringing a class action, they will have to bring it on behalf of the entire class. This case really ended up not being a class action in that something less than 10 percent of those who were contacted ended up wanting to remain in the case.

So, the anti-trust cases that are now in court in Kansas City, San Antonio, and the private treble damage actions that we have are going to set the tone and be very important in terms of the operation of cooperatives, especially milk cooperatives in the future. I suspect that in 1973 we will have some developments.

Next, a comment on Federal order cases. You understand, of course, that a Federal milk order has certain minimum compulsory aspects about it. I was listening to the discussion today regarding various criticisms and comments as to what the government and their bureaucracy accomplishes. I think we should remind ourselves every now and then that the producers and producer cooperatives have requested and obtained these Federal orders. They seem to be almost universally popular. We may see them some day even in California where I believe their milk marketing system has much to be desired, and I think that system could stand a searching analysis in relation to some of the comments made here today.

But, when we assess what we want in terms of compulsion, we should remember that the big thing that the Federal order did and the shocker that it was to the milk dealers back in the 30's was the simple fact that at its level, the minimum price level, and at its terms, it was compulsory on the non-cooperator. No farmer can sell milk below the price fixed in the Federal order, and if you say that no farmer ever did, I hasten to correct you. There were times when farmers have tried to sell at less than the Federal order price in order to have a market, whereupon the Federal order required that the dealer pay that farmer the minimum Federal order price. Various types of evasion have occurred. Therefore, when we talk about extending compulsory aspects such as this to other legislation, we should keep in mind what certain elements in the market might try.

There was one important case last year that I think was helpful and set to rest some of the issues revolving around location differentials. This was the Sunnyhill Case in Missouri, and again the Circuit Court of Appeals decision upheld the statutory authority for location differentials and pretty well restored things to where we thought they were before, In effect, the Secretary of Agriculture, after a hearing, can set different prices under the same Federal milk order, such as in the Ohio valley order where a producer serving Dayton, Cincinnati, or Columbus is serving the zero zone; if he sends his milk to Northwest Ohio he gets a nickel less; if he sends it to Southeast Ohio and West Virginia, he gets a nickel more. A decision in the Fairmont Case raised questions about it and the District Court in Missouri had held that the Secretary had to fix the same price in one order. The Circuit Court, after looking it over, decided that the statute and the Marketing Agreement Act was very clear. You can have different prices in the same order, and I think it pretty well set to rest that issue for some time. That does not mean, however, that the nearby differential which some of you have heard about was revived. The idea that the Secretary of Agriculture could prescribe for those farmers outside a metropolitan area very close to town, a Class I price or any price because of their farm location, without regard to where the milk was delivered -- that concept is still dead and has been declared illegal and the Department to this day maintains the nearby differentials are out of the picture. This means that if you are in Franklin County and costs get high and taxes get higher and even though your milk buyer is right next door, the Secretary cannot fix a higher price there regardless of where your milk goes. He can fix a higher price for all milk going into Franklin County to a milk dealer who is located there, but just because your farm is there, you can't get it. The question of farm-point pricing is another matter altogether. That is created in relation to the cost of hauling to the market, and I think there are some questions on the legality of that, that are evidently not being litigated.

And finally, a comment about the Agricultural Fair Practices Act. Two cases are still pending, one the so-called Lawson case or Weir case in Federal District Court. In Cleveland there is a motion pending for a summary judgment agreed on by parties. In other words, the judge has the case and the briefs have been filed. Evidently the Lawson Milk Co. takes the position that they do not have to buy any milk from a farmer who joins a cooperative. On the other hand, the government agency that brought the action insists that simply because a man joins a cooperative is no reason to reject him, and it doesn't give the buyer the right to discontinue purchasing that producer's milk. I understand that some of the government people have serious qualms about whether or not they should seek an order requiring the handler to purchase milk from the farmer who joined the cooperative. Part of that, I'm sure, is occasioned by the language of the Act itself, which does talk about the producer and the handler still being able to contract in spite of what the statute says.

I think a more happy result was reached in the second case which, I think, is Liechty vs. Hunt-Wesson, a case already referred to by previous speakers, in the Western District Court of Ohio in Toledo. Judge Young had no problem with that particular Act. In fact, he felt the Act went so far as to bring to an end a period in which a buyer can threaten farmers or paint pictures for them to show that if they join the coop, they are going to be out of a market. However, the Circuit Court of Appeals in Cincinnati reversed the District Court to the extent that the injunction requiring Hunt-Wesson to offer a contract and thereby really make mandatory a contract for the purchase of tomatoes was reversed. Instead, the judgment allowed the canners to put up a very substantial bond prior to a retrial, whereupon the parties negotiated a settlement and gave these particular growers a contract that certainly accomplished what was sought in the first place. Also, the settlement evidently indicated that the canners might behave better in the future; certainly for a period of time they will behave much better. This has been our experience in court cases when the handlers seek to make coops defendants and then lose their marbles in the courtroom.

There were other developments during the year, none of which have lead me to recollect any cases. I mention environment which will continue to be a significant problem to anyone operating properties and for individual farmers with large operations. Therefore, I would say, as of this time, we are looking forward to some cases and pronouncements on the anti-trust front. I think the results will affect both the operations as we now know them, the announcement of premiums, and maybe more importantly, the future of bargaining legislation. This is so because the thrust of potential bargaining legislation is in part the anti-trust exemption into certain activities of bargaining.

COPING WITH RUMP GROUPS AND NON-MEMBERS

W. T. Osborne
Secretary-Treasurer
Cincinnati Cooperative Milk Sales Association

If there were any real answers to this problem, it wouldn't be on the program and I wouldn't be here.

Rump groups, as we are acquainted with the term and the groups today, are more vexing than non-members. Not inherently, but because the USDA is allowing or enforcing different measures of enforcement for different groups -- or so it seems to me.

The USDA causes all cooperatives to file an "Annual Report of Cooperative Milk Marketing Association" and "qualification" is at issue. If qualification is not predicated, in part, at least, on this filing, then we should find out why we file.

Certainly it would appear that the NFO could not acceptably prepare this form if for no other reason than that it is not a cooperative; but, by some alchemy they have filed and have been "qualified." Other rump groups over the years have sprung up and died. Prior to the NFO, these rump groups never were qualified to receive payment on behalf of those alleged to be members. If rump groups cannot get control of some member money, they will die. If they gain some control, they have a lifeline. Their members can apparently bleed a long time.

Perhaps the NFO can no longer be called a "rump group." It may be that any group who pays attorneys fees of the size that it must be paying has arrived. A group that can "cut prices" -- offer milk of producers to handlers at prices less than that offered by the regular cooperatives -- may be the cooperatives' competition. If this be so -- whether a rump group or not -- if the NFO is our competition, then it must be determined whether a group organized as a "non-profit" association, organized as a debating society (Knights of Columbus, Masons, Knights of Pythias, etc.) is free to engage in commercial competition with a cooperative. A cooperative, some of you may say, is a "non-profit" association because the law (in Ohio, 1729.01(D)) so provides. But the same statutes immediately proceed to strip from the cooperative most, perhaps all, of the advantages of "non-profit" status, particularly the tax paying aspect. All cooperatives pay franchise tax, personal property, and real property taxes as a regular corporation for profit; and now, in Cincinnati we find the Board of Review of the Cincinnati Income Tax Bureau finding that a cooperative must pay income tax as a corporation -- in spite of the provisions of 1729.01(D). A "non-profit" corporation, as such, pays none of these taxes.

In part, this question has been put before the Federal Court in Kansas City, and as a way to handle a rump group, the Secretary of the State of Ohio should be forced to question the NFO's right to do business in Ohio. One of the things the NFO needs most right now is another real good lawsuit.

Any rump group will usually be found short of funds and any defense or action against them that forces the use and expenditure of money is a good way to deal with them.

In dealing with the non-members, we are dealing with a different type problem. USDA protects and furthers the position of non-members (but what about labor - if non-union, no work on projects in which there are Federal Funds). Of course, those who profess membership in a rump group may be "non-members", and, as they are found to be shipping milk to market on routes nominally controlled by a cooperative, they should be treated as any other producer who is not a member of the milk marketing cooperative. If, in fact, a rump group producer has signed a contract with a cooperative, the opportunity to enforce it is there and he is not then a non-member. There are a few "thou shalt" or "thou shalt not" provisions in some phase of law.

In the Internal Revenue Code we find these "shalt nots" and they pertain only to "tax exempt" status (that means the right or duty to allocate all receipts, as opposed to only receipts from marketing).

Sec. 521 (1954 Code) and Sec. 1381 (Part I, Subchapter T) and applicable rules provide:

1. Exemption will not be denied if a cooperative does not do more business with producers who are not members than with producers who are members; and,

2. Does not do more than 15 percent of its business with persons who are not producers. (These same requirements are to be found in the Ohio Law at Sec. 1729.03(A).)

3. Now in the regulations (IRS) we find these words: Cooperative dairy companies which are engaged in collecting milk and disposing of it or the products thereof and distributing the proceeds, less necessary operating expenses, among the producers upon the basis of either the quantity or the value of milk or of butterfat in the milk furnished by such producers, are exempt from the tax. If the proceeds of the business are distributed in any other way than on such a proportionate basis, the association does not meet the requirements of the Code and is not exempt. In other words, non-member patrons must be treated the same as members insofar as the distribution of patronage dividends is concerned. Thus, if products are marketed for non-member producers, the proceeds of the sale, less necessary operating expenses, must be returned to the patrons from the sale of whose goods such proceeds result, whether or not such patrons are members of the association.

   I can easily translate this to read that you may not charge non-members more than members.

Within the framework of these three points, then, it should be possible to devise a plan for including non-members in the marketing plans of cooperatives. Once this is done -- and it is the thing to do -- there is no longer an important non-member problem with which to cope.

Haul their milk; test their milk; maintain normal quality checks; direct non-member milk with member milk on loads; collect and pay super-pool. In short, do what you can on behalf of the non-member and -- if you can get hold of some of the money moving to him -- charge for the service. To fail to do these things could be "punitive" and unlawful. So be lawful and eliminate the problem.

PROSPECTS FOR LEGISLATION TO ADVANCE COLLECTIVE FARMER BARGAINING

Dennis R. Henderson
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The Ohio State University

Improving farmers' economic position through group action has been a long sought goal. Recently, however, considerably more attention has been focused upon bargaining than upon other forms of collective action. Today, I'll attempt to set the perspective for bargaining from the farmer's point of view, to review the status of bargaining legislation, and trace out the prospects for future legislation that will facilitate collective bargaining by farmers.

Collective bargaining in agriculture is normally considered to be the negotiation of price and other terms of sale between an organized group of producers and the handlers or processors of the farm commodities they produce. There are several situations when collective bargaining is a viable alternative to the current market situation.[1] These include:

1. Where one side of the market for a commodity is marked by high concentration of power, farmers may need to organize as a means of developing a degree of countervailing power.

2. Where the open market-price discovery mechanism for a commodity has totally collapsed, as it virtually has in eggs, producer groups may be warranted in implementing some kind of bargaining system to determine price and other terms of trade.

3. Where the processing and retailing systems rest heavily upon non-price competition such as promotion, product differentiation and merchandising, trading conditions do not splice well with a farm marketing system oriented primarily toward price. Collective bargaining may be a feasible way to link the two unlike market systems.

4. Where pricing of farm products has given away to contracts, particularly where contract-making has become a processor dominated activity, farmer bargaining cannot only improve equity, but also stability.

5. Where a commodity suffers from recurrent cycles of overproduction, the bargaining process, with adequate support by producers, could help stabilize production in line with demand.

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[1]For elaboration, see Breimyer, Harold F., "The Problem and Its Setting," in <u>Bargaining in Agriculture-Potentials and Pitfalls of Collective Action</u>, North Central Regional Extension Publication 30, University of Missouri Extension Div. C911, June, 1971, pp. 3-7.

6. Where the marketing system continues to seek a more orderly flow of commodities from the farm into the processing sector, bargaining may assist. While bargaining is not basically a product flow device, bargaining associations may use this as a means of achieving economic gains and strengthening their bargaining position. Certainly the dairy bargaining cooperatives have demonstrated this.

Additionally, as it is a human trait to reason mainly by analogy, many farmers see promise in collective bargaining because they have witnessed successful bargaining by labor unions. Much publicity is given to favorable wage settlements achieved through bargaining by labor unions. Such publicity has interested many in collective bargaining as a means for obtaining higher prices. This possibility has not been lost on farmers, as indicated by their responses to questions concerning the best method for obtaining fair prices for grain and livestock (Table 1). You will note that the majority of producers feel that some type of group action, including collective bargaining, is the most effective way to obtain fair prices for these commodities.

This pro-bargaining attitude is particularly impressive in view of the relatively small amount of bargaining activity for these commodities in the past. On the other hand, however, some might argue that it is this lack of exposure to collective bargaining that explains its high regard with grain and livestock producers.

While some farmers do not believe collective bargaining is the most effective way of gaining fair prices, the overwhelming majority feel that some form of collective bargaining in agriculture is generally desirable (Table 2). And, contrary to some professional opinions, there seems to be no strong feeling among producers that collective bargaining is applicable only for contract crops. Note that only a small percentage of farmers feel it has no place in agriculture. Thus, it is clear that most farmers do feel that there are advantages to collective bargaining in agriculture. When asked how they might achieve bargaining power, farmers are about evenly divided between those that prefer to organize and run their own bargaining groups without government help and those that feel some form of governmental involvement is desirable (Table 3).

This sample is a little misleading, however, because there is not a clear cut dichotomy between some governmental involvement and none. Certainly, it takes some action, or at least overt inaction, by the government for farmers to organize an association that they operate themselves, if nothing more than enabling legislation such as the Capper-Volstead Act giving farmers the right to organize. Governmental involvement can stem from this extreme across a wide range of possibilities to, at the other end of the continuum, where the governmental unit conducts the bargaining on behalf of all parties and mandates prices and terms upon the entire industry.

Several legislative measures have been enacted or proposed, both federally and within various states, that facilitate farmer bargaining somewhere along this continuum. First, I will review briefly the federal measures and then look at the status of bargaining legislation in a few states.

The only significant federal legislation that has actually been enacted is the Agricultural Fair Practices Act of 1967. Essentially, this act provides for the protection of farmers' rights to organize and prevents

Table 1. Farmers' Responses to Various Methods of Obtaining "Fair" Prices for Grain and Livestock

Method of Obtaining Fair Price	Percent Response[a]	
	Livestock	Grain
Collective Bargaining Associations	42	35
More Cooperative Marketing	8	35
Present System with Price Supports	7	21
Present System without Price Supports	36	7
Other	7	2
TOTAL	100	100

[a]Unweighted average of non-representative samples of Illinois and Missouri farmers.

Source: Adapted from Guither, Harold D., "Bargaining in Agriculture -- Potentials and Pitfalls for Continuing Education Programs Among Livestock and Grain Producers," paper presented at the AAEA Annual Meeting, Gainesville, Florida, August 20-23, 1972.

Table 2. How Farmers View Collective Bargaining in Agriculture

	Percent Response[a]
Generally Desirable	78
Desirable Only for Contract Crops	8
Desirable Only with a Central Marketing Board	6
Bargaining has no Place in Agriculture	6
TOTAL	100

[a]Unweighted average of non-representative sample of Illinois and Missouri farmers.

Source: Adapted from Guither, op. cit.

Table 3. Farmers' Responses to Various Methods of Achieving Bargaining Power

	Percent Responses[a]
Farmers Organize and Run Their Own Associations	41
Organize Bargaining Associations with Government to Enforce Rules	43
Neither of the Above will Work	16
TOTAL	100

[a]Unweighted average of non-representative sample of Illinois and Missouri farmers.

Source: Adapted from Guither, op. cit.

discriminatory practices on the part of buyers due to a producer's membership in an organization. There is no provision in this act that requires buyers to deal with a producer association, but based upon limited evidence, it does appear that discrimination by handlers against producer groups will be reduced under its provisions.

There are four additional bills that have been introduced in Congress. These cover a range beginning where the Fair Practices Act leaves off, extending to price committees with authority to set production levels and determine prices.

The Agricultural Marketing and Bargaining Act, better known as the May Bill, would extend the Fair Practices Act of 1967 to make it unlawful for a handler or processor to refuse to negotiate prices or other terms of trade with farmer bargaining associations. It defines a bargaining association as a group of producers which has as its principal function, as an agent of the producers, the negotiation with handlers of prices and other terms of contracts with respect to production, sale or marketing of agricultural products. A key phrase in this definition is that the association has as its principal function to bargain on behalf of its members. Note that this does not exclude it from engaging in other activities such as distributing product, disposing of surplus production, operating a supply pool, or the like. I will refer to the importance of this provision later. Nothing included in this bill provides for the certification of bargaining associations, supervision of the bargaining process, or the arbitration of disputes, and the measure would not compel handlers and associations to reach an agreement.

Governmental involvement in bargaining under the provisions of this bill would be minimal. Much of the opposition to this bill seems to stem, in fact, from this minimum involvement. Proponents of bargaining legislation argue that the bill does not go far enough toward providing for a suitable outcome of the bargaining process. Some have also been concerned that processing cooperatives are not specifically excluded from the handler category. There seems to be relatively little possibility that this bill will be enacted, particularly in view of the lack of support among bargaining proponents.

The legislative proposal that has received the most attention in the current session of Congress is a bill entitled the National Agricultural Marketing and Bargaining Act, more commonly referred to as the Sisk Bill. This bill creates a national agricultural marketing board, provides standards for accrediting associations of producers and defines the mutal obligations of bargaining associations and handlers. The act requires good faith bargaining on commodities produced under contract and makes it unlawful for a handler to negotiate with other producers of a given commodity while negotiating with a qualified bargaining association. The association has recourse to the bargaining board if handlers refuse to bargain. There is nothing in the bill that obligates either party to agree to any proposal or make any concession. Also included is a provision exempting processing cooperatives from the status of handler and another that prevents handlers from combining or conspiring with one another in bargaining with qualified associations. That is, associations must bargain with handlers individually as handlers would be prevented from combining to bargain jointly with an association of producers. These two provisions, I believe, require careful analysis.

Obviously, cooperative processors would prefer to be excluded from the bargaining process and have been a powerful lobby in favor of this provision. By excluding processing cooperatives from the bargaining requirement, they gain a definite comparative advantage, vis-a-vis their non-cooperative competitors. I well realize that philosophically the cooperative processor is an off-farm extension of the farm enterprise, and as such, the sum-gain to the producer from his processing cooperative should be as large as his sum-gain from bargaining with non-cooperative handlers. Thus, the producer should be indifferent toward bargaining if he is shipping to his cooperatively owned processing plant, and the processor can be exempted from bargaining. In practice, however, it doesn't work that way. There are many good examples that processing and high returns to the producers aren't compatible. The inclination of directors of cooperatives when they have an investment in processing facilities is not much different from directors of other firms with similar facilities. They tend to concentrate on profitable operation of the processing facility, even if it means low returns to their producer-members. Thus, exempting the cooperative whose primary business is processing from bargaining could give it a substantial competitive cost advantage with little, if any, economic gain to its producers.

This seems somewhat unfair to non-cooperative processors. This problem could be overcome by adopting the language similar to that in the May Bill, which would allow bargaining associations to participate in some aspects of product handling as long as the principal function of the association is bargaining for its members. Bargaining associations could then engage in supply management programs necessary to enhance their bargaining position, as many dairy cooperatives now do, yet an unfair competitive advantage would not be created for those cooperatives whose primary function is processing.

My second concern is with the language preventing handlers from combining to deal uniformly with a bargaining association. If handlers cannot act in concert, a bargaining group could arrange different and non-uniform terms and prices with different handlers. This could put some handlers at a disadvantage vis-a-vis others with regard to procurement costs and other terms of trade. Furthermore, it seems philosophically inconsistent to grant rights which substantially increase the bargaining power of one group; that is, the producers, without granting similar power to the parties on the other side of the bargaining table.

Other important provisions of the Sisk Bill that deserve mention are the provision for assessment of member dues to be withheld by the handler and the extension of market orders under the Marketing Agreement Act of 1937 to additional commodities.

All things considered, legislation similar to the Sisk Bill probably has the best chance of being enacted by a subsequent Congress, but enactment is not likely until some of these key issues are resolved.

The remaining two bills in the federal hopper are the National Agricultural Bargaining Act and the National Agricultural Marketing Act, better known as the Mondale Bills. The bargaining bill establishes a board that would supervise, upon petition, the election of commodity marketing committees which would be responsible for negotiating on behalf of all producers of that commodity prices and other terms with representatives of prospective purchasers. Provisions are also included for the board, in conjunction with marketing committees, to determine for any commodity an amount that may be produced in any marketing period and to allocate that quantity among producers. This supply control provision raises some serious questions, the answers to which are not included in the bill. How can the equitable distribution of marketing rights among existing producers be assured? Also, how can undue barriers to the entry of new producers be prevented? There are no provisions in the bill to assure an equitable distribution of marketing rights among existing producers or the assignment of such rights from one producer to another or to potential entrants. In overcoming this problem, it is important to design a mechanism whereby the value of the future stream of income generated by the marketing rights is not capitalized into the current value of that right. Too often that happens, and only the original owner receives any financial benefit from the establishment of such rights, thus benefiting only existing producers and not future producers. It is most difficult to design a system that would prevent the capitalization of future income into a given asset; witness tobacco marketing rights. Thus, the chances for adoption of this provision with an assurance of equity for both existing and future farmers appears somewhat dim.

The second Mondale Bill, the National Agricultural Marketing Act, would remove exemptions in the Agricultural Marketing Agreement Act of 1937 for certain agricultural commodities, thus extending the market order provisions of that act. It further provides a method for establishing collective bargaining in good faith between producers or associations of producers within a market order and handlers or groups of handlers with whom they deal. Minimum prices and other terms of trade so negotiated would become binding upon all handlers when agreed to by handlers acquiring 50 percent of the commodity sold by the producers in the market order area in the preceding year.

The major distinction between this bill and the Mondale bargaining bill is that it covers only producers in a given market order area, whereas the bargaining bill would extend mandatory coverage to all producers of a given commodity. Therefore, under the marketing act, producers in one area could be covered by collective bargaining and market order provisions while those in another area might not be covered or be subject to different agreements. Thus, under this provision, producers in a given market order area would be subject to the types of inter-regional competition that have increasingly caused problems for dairy producer associations under the dairy marketing orders. I question the wisdom of legislating similar types of inter-regional problems for other commodities.

An additional provision in the Mondale marketing act allows the Secretary of Agriculture to set forth production and/or marketing rights, a provision to which I would again raise the question of equity and fairness to existing and potential producers.

It is now obvious that there is a wide range of provisions to facilitate collective bargaining set forth in the various legislative proposals being considered by Congress. None of these proposals exists free of serious questions concerning the performance that would result from their enactment. Until these questions of equity, fairness, and flexibility are resolved, enactment is not likely.

I would like to turn now from federal legislation to collective farmer bargaining laws and proposals in a few key states. From these, some implications can be drawn concerning the likelihood of future legislation, the types of provisions that might be encompassed in such legislation, and some strategies that might be used by proponents for securing such legislation.

California is probably the leading state with regard to farm bargaining legislation. That state has enacted laws that cover specific commodities with what are essentially state marketing orders, the terms of which are bargained over between producers and handlers. The provisions are quite similar to those in the Mondale marketing bill. Under the California measure, the state department of agriculture oversees bargaining between accredited producer groups and handlers or groups of handlers. When handlers who, in total, account for a prescribed percentage of the total purchases of a commodity agree to a given price, that price then becomes a legal price and all handlers are obligated to this as a minimum. The system seems to operate reasonably well for those specialty crops grown in California for which there is relatively little competition from other regions. Its applicability to other commodities would be limited, as is any regional marketing order or bargaining scheme, by the possibility of in-shipments from competing areas. At the present time, there are no reports of additional farmer bargaining legislation being considered in that state.

In Ohio, collective bargaining legislation has been proposed in House Bill No. 838. This is somewhat similar to the Sisk Bill. Essentially, it establishes a state bargaining board to oversee the bargaining process, sets standards for bargaining associations, and makes it unlawful for a handler to refuse to bargain in good faith with an accredited producer association. Other unfair practices are outlined which make discrimination unlawful and assure a fair game. In the Ohio proposal, membership in a bargaining association is voluntary and the handler is not obligated to deal with non-members on the same terms as he agreed to with the association, although he would be prohibited from offering a higher price to non-members than to members. This provision does, however, open the door for free riders; that is, non-members could receive the same favorable terms achieved by the bargaining association, yet would not be obligated to share in the costs of the bargaining effort.

The Ohio bill specifically exempts processing cooperatives from the status of handler and on this point is subject to the same criticism as the Sisk Bill. This bill was killed in a house committee in the 1972 session of the Ohio General Assembly, but will undoubtedly be reintroduced again, and with some modification, stands a reasonably good chance of being enacted.

One of the most interesting state proposals is Michigan Senate Bill No. 1225, known as the Michigan Agricultural Marketing and Bargaining Act. Like the Ohio proposal, the Michigan bill calls for the establishment of a bargaining board, sets standards for accrediting producer associations, and outlines unfair bargaining practices. Unlike the Ohio bill, however, the Michigan proposal creates what is essentially a union shop. Under the Michigan proposal, when a majority of the producers representing at least 50 percent of the commodity sales agree to be represented by an association, then all producers of that commodity in the defined marketing area are bound by the actions of the association. This eliminates the free rider problem. Additionally, the union shop provision gives additional bargaining strength to the association as it speaks for all producers of a commodity in a given area rather than its members only.

The bill also sets up a formal procedure for adjudication of disputes. This is a provision not included in most other legislative proposals, but conceivably is an important ingredient to the long-run success of collective bargaining by farmers. The Michigan arbitration procedure calls for each party to a dispute to submit a final offer. A tripartite board then selects one for a binding solution.

Just a note on this provision. Such a procedure could very easily lead to the development of gamesmanship more than the achievement of satisfactory solutions as each party attempts to pursue a strategy that will lead to acceptance of their offer rather than the opposition's offer. It is doubtful if either party's final offer would be <u>completely</u> just. More likely, a satisfactory solution contains elements of the offers made by each party and the appropriate adjudication procedure would be to have an impartial party, such as an arbitration board, arrive at a compromise solution. The Michigan bill also has the common, but troublesome, exemption for producer cooperatives primarily engaged in processing from the handler status. This bill has passed the Michigan Senate, has been reported out of the House Labor Committee, and is currently before the House where it is rated as a "toss-up."

It is interesting to look briefly at the sources of support for and opposition to this type of legislation. The strongest support in Michigan has come from (1) the Michigan Farm Bureau, which views this type of legislation as a means of strengthening their position as a representative of all farmers, (2) from the vegetable and fruit producers, who have been under substantial economic pressure and feel a strong need for higher prices, and (3) from organized labor. Labor interests in general support collective bargaining legislation as they view this as part of the rules of a fair game. The natural opposition to farmer bargaining legislation comes from processors and other handlers of raw agricultural commodities. In Michigan, the opposition has been led by the food retailers association. The Michigan food retailers association, however, is strongly influenced by large integrated retailers who are also processors. Processors generally feel that they will lose the most if their suppliers gain increased bargaining power.

Additional opposition has come from the Livestock Feeders Association, whose members view themselves largely as processors, buying their inputs -- feed and feeder livestock -- from farmers who would gain bargaining strength through such a measure. Opposition has also come from smaller cooperatives and bargaining units such as the National Farmers Organization, who feel that the union shop provision strengthens the position of the larger farmer organizations to the detriment of their own associations. This is a concern based upon a solid foundation. Certainly, the larger the bargaining association is, the more effective it can be on behalf of its producer-members. Thus, the quest for effective bargaining by farmers will generate increased interest in large organizations. The moving forces behind most future efforts to support collective bargaining legislation will undoubtedly come from the large organizations, such as the Farm Bureau and the major dairy cooperatives. Additional support seems likely to be forthcoming from organized labor and, indeed, it seems that a viable coalition between labor and agricultural interests might not only be feasible, but also desirable for securing future legislation.

Looking again to national legislation, what are the chances for a stronger farmer bargaining law emerging in the near future? The Sisk Bill was killed in the House Agricultural Sub-Committee on Domestic Marketing and Consumer Relations by a three to five vote in mid-September. The three to five vote is significant in that Congressman Foley, the chairman of the sub-committee, voted against the measure even though he didn't have to vote and his negative vote was not required to defeat the measure. This is a strong indicator that there is no chance for early revival of this bill in Congress. As the Sisk Bill has received the most favorable response in this committee, it is doubtful if the other proposals will be seriously considered by this Congress.

Chances of bargaining legislation don't appear to be particularly good in the upcoming sessions of Congress. First, there is no language supporting collective bargaining for farmers in the official platform of the Republican Party and no serious support in the Democratic Platform. Thus, it would appear that neither party is really committed to push for bargaining legislation in the near future. Furthermore, collective bargaining will probably not receive favorable attention by Congress unless there is a great deal of pressure upon them from farmers. Farmers cannot be expected to exert much pressure for price relief when their incomes are relatively high. In 1972, farm incomes set an all-time record high and the outlook for 1973 is again for relatively high incomes. Therefore, there isn't much reason to believe that farmers will pressure for any type of new price-improvement legislation, including bargaining, until they are again in a tight income situation. This will probably not occur until 1974, at the earliest.

Most farmers place great value upon the traditional freedom of making their own decisions about what they will sell and what price they will accept. As long as their incomes are reasonably satisfactory, they will undoubtedly opt to preserve this freedom rather than to bargain it away in order to realize monetary gains. With a period of two years or more likely before serious pressures again mount for enactment of bargaining legislation, the burden falls directly upon those of us concerned with the equity of the farmer's economic position in today's society vis-a-vis those with whom he deals to come up with provisions and proposals for collective bargaining legislation that will overcome the serious objections to current proposals, and that will be fair, equitable, and operationally feasible.

IMPLICATIONS OF THE NMPF SUPPLY MANAGEMENT PROPOSAL

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We only have to look at the current phase of the milk production cycle to know whether or not the dairy industry is interested again in production controls. At the present time (autumn, 1972), we appear to be in the middle of a substantial expansion in milk supplies, and no apparent let-up is in sight. After bottoming out at 116.3 billion pounds in 1969 at the conclusion of our last cycle, milk production has been increasing steadily each year and will approximate 120.6 billion pounds in 1972. Preliminary estimates suggest another 1-billion-pound increase in 1973.

The concern of milk producers, of course, extends to the price implications of supply expansion. In spite of expanded supplies, producer prices have continued their upward movement since 1969. The Ohio producer pay price for all milk will be about $6.30 per cwt. in 1972, up by 17 cents from 1971, and 54 cents higher than the $5.76 per cwt. price recorded in 1969. While this appears to fly in the face of economic principles of pricing, given the greater supply, it is the time lag questions that we don't have good answers for. How sensitive are current prices to current supplies? How soon are production decisions made and implemented in relation to significant price changes? I think it is fair to say now that the attention supply management is drawing in the milk industry is primarily related to a collective estimation that (1) production increases are now occurring because of significant price increases that extend back into the mid-60's, (2) current price strength means even a further extension of the production cycle upwards, and (3) production controls may be essential as a means of protecting the present price level.

Even here in Ohio, where we have seen a considerable shift away from milk production since 1955, the new enthusiasm for milk production has been registering itself. In 1971, for the first time in a decade, we saw more milk produced in Ohio than was produced in the previous year. And in 1972, Ohio production is surging even more (plus 3 percent), and we'll be at around the 4.6 billion pound mark for the year. When we see this recent push in milk production in an area where grain and livestock enterprises have been replacing a lot of dairy, then we have to believe that the strength in producer milk prices is generating a supply situation that could be distressing to the milk industry.

The one major consideration that has taken a lot of the edge off the increasing milk supply situation has been the recent strength in commercial sales of milk and dairy products. Most of us have been pleasantly surprised by the favorable demand picture. Overall, it now appears that commercial disappearance of milk in all dairy products will increase by nearly 3 percent in 1972. And for the first time in many years, per capita consumption will go up slightly (562 pounds m.e.) instead of going down substantially. Cheese and the low fat skim fluid products lead the parade, but most other dairy products are also doing well in the commercial market.

The increase in demand has been such that, even with more milk production, CCC purchases in 1972 will be down markedly from 1971. Price support purchases in 1971 amounted to 7.3 billion pounds, but they will drop to less than 6 billion pounds in 1972. This cost relief to the support program will, in itself, remove pressures for supply management.

However, the milk industry, particularly as expressed through the National Milk Producers Federation, continues to sense the responsibility for evaluating alternative means of managing the national milk supply. As a minimum, it is recognized that even the enabling legislation or potential machinery for supply management do not exist and that exposure to possibilities in this direction are essential. While most members of the Ohio Milk Producers Federation at this seminar have had a chance to review the NMPF proposal, the same probably is not true for participants of the Ohio Farm Bureau Federation. I therefore propose to (1) describe the basic elements of the NMPF proposal, (2) consider the base valuation question in some detail, and (3) leave most of the implications discussion to Bob Brewer and Eldie Vickrey.

In order to control farm production, you obviously have to have participation by producers. There are two routes to get participation -- (1) voluntary, with incentive, and (2) mandatory, with penalties. The NMPF proposal essentially adopts the mandatory route, although the proposal asks only for enabling legislation that would permit scheduling of a referendum on the issue among milk producers.

The referendum issue would be defined in terms of two options. The options would be either (1) a 75 percent of parity price support without production controls, or (2) an 86 to 90 percent of parity price support with production controls. At the present time, the 86 to 90 percent option would mean a price support level a little more than $1.00 per cwt. higher than the 75 percent option.

Seven basic provisions of the supply management proposal are noted:

1. The recent three-year <u>history of marketings</u> would be reported for each producer.

2. Bases would be extended to all producers selling 50,000 pounds or more of milk annually.

3. Bases would be extended to both Grade A milk and manufacturing grade milk.

4. The Secretary of Agriculture would announce a <u>national quota</u> each year.

5. The <u>national quota</u> percentage would be applied to the individual <u>history of marketings</u> in order to establish an individual <u>base</u>.

6. A penalty price would be placed on over-base marketings.

7. Bases would be transferable among producers.

The combination of (1) an individual producer's history of marketings with (2) a national quota would provide for (3) the individual producer's base.

1. History of Marketings -- A history of marketings would be established for each producer based on the amount of milk he marketed during the immediately preceding three years. By way of example, if the program was now in operation, we can assume the following situation for establishing 1972 base for a Mr. Producer.

Year	Mr. Producer's Average Daily Delivery
1969	1,900
1970	2,000
1971	2,100
	Average = 2,000 lbs.

In this example, the 1972 history of marketings would equal 2,000 pounds. In 1973, the history would be based on the 1970-71-72 period and so on. Also, at the outset of such a program, the history average would be determined in the first year only on the preceding year's marketings, the second year on a two-year average, and the third year on a full three-year average.

2. National quota -- The second step in assigning base would be up to the Secretary of Agriculture. Each year, the Secretary would (1) estimate U. S. milk production for the coming year, and (2) estimate how much milk is actually required for the commercial market and other priority needs. The national quota would be determined from these two estimates. An example for 1972 will help us here:

Estimated production for 1972 - 120 bil. lbs.
Estimated needs for 1972 - 114 bil. lbs.

National quota would equal $\frac{114 \text{ bil. lbs.}}{120 \text{ bil. lbs.}} = 95$ percent

3. Base -- The quota announced by the Secretary would then be applied to each individual's history of marketings. For our Mr. Producer with his 2,000-pound-per-day history of marketings, 95 percent, or 1,900 pounds would be assigned as base, and all milk sold in excess of the 1,900 pounds would be defined as excess milk subject to a penalty price. The base milk would enjoy the high 86-90 percent of parity support, and monthly pay prices would be determined in the same way they presently are calculated. The penalty price for milk over base would finally be at such a level as to discourage over base milk production. This might require penalty prices for milk in Ohio as low as $3.00 per cwt. The average total cost of producing milk in Ohio has recently been about $5.40 per cwt. Approximately 60 percent of this cost, or $3.25, is out-of-pocket cost. Unless the penalty price for milk is equal to or less than the out-of-pocket cost of producing milk, there won't be a significant cut-back in milk production.

If the base price for Grade A milk in Ohio markets was $6.50 per cwt., and a price for over base milk of $3.00 per cwt. was established, the $3.50

difference would be remitted to the U. S. Department of Agriculture. The Department would use this money to help pay for costs of the dairy price support program.

Thus far, only a general approach has been worked out, and many questions don't have answers yet. But some key issues can be discussed.

1. It is intended that if the supply management program was approved in referendum, it would continue indefinitely until conditions indicated that a new referendum would be appropriate.

2. Bases would be transferable among dairy farmers within the same state or from a producer in one state to a producer in an adjoining state.

3. New producers could acquire base by purchasing existing base or by building their own base. To build base, the new producer's history of marketings would be established at 50 percent of his marketings in his first year, and he would gradually build his history until he was on the same basis as all other producers in his fourth year of production.

4. Bases could acquire substantial values. A wide difference between the base price and the penalty price would be the key factor in high base prices. However, the three-year moving average to be used in determining the history of marketings would dilute base values somewhat because a producer could build rather than buy base.

5. It is proposed that the national quota be applied uniformly across the United States. In areas where milk supplies are deficit, the feasibility and acceptability of such an approach is a real question mark.

We can leave these matters to discussion. I want to turn now to the matter of base valuation. Since the incidence of bases has been pretty remote to us here in Ohio, I believe there's some point to laying out the concept and an approach to base valuation. Of course, bases take on value because you can get a better price for your milk with base than without base. But how do we translate that price advantage into a fairly precise idea of what base in worth?

Three factors are relevant to the valuation of base. These include:
(1) the anticipated difference between the base price and the excess price;
(2) the length of time that it is expected that base will have value; and
(3) the degree of certainty that the base plan will last through that period.

1. Difference Between Base Price and Excess Price

The two large fluid milk pools in Ohio are currently both running about 67 percent Class I utilization. The Class I prices are near $7.05 per cwt. and the Class II-III prices are near $5.04 per cwt. As a result, blend prices of $6.38 per cwt. are being generated.

With a base plan, and with the market base fixed at the Class I volume plus 20 percent, and with the Class prices as presently noted, then

(a) the base price would be $6.72 per cwt.
(b) the excess price would be $5.04 per cwt.
(c) the difference equals $1.68 per cwt. or 1.68 cents per pound.

2. Duration of Time that Base Will Have Value

While most groups moving into base plan operations probably will expect an extended period of time for base plan operation, the three-year moving average used for the history of marketings can be interpreted to mean that a given "pound of daily base" will have a three-year life. This means that base values are to be calculated in terms of a three-year life. After all, in periods of longer than three years, bases are earned merely by performance on the market.

3. Probability that Base Plan Will Stick

Since only a three-year period is relevant in evaluating the base value question, the buyer and the seller of base are both pretty well assured that the base plan will last at least that long. There is therefore close to a 100 percent probability factor that can be used in valuing base.

We can now raise the specific question: "What is the value of one pound of daily base?"

given --

(a) Difference = 1.68 cents per pound
(b) Time period = 3 years
(c) Degree of certainty = 100 percent
(d) Cost of capital, or interest rate = 8 percent

The value of one pound of daily base in a one-year period could be figured as follows:

1.68 cents per pound per day x 365 days = \$6.132 per pound of daily base for a one-year period.

Then, the present value of one pound of daily base for a three-year period could be as follows:

$$\underbrace{\frac{\$6.132}{1.08}}_{\text{Year 1}\ \to\ \$5.88} + \underbrace{\frac{\$6.132}{(1.08)^2}}_{\text{Year 2}\ \to\ \$5.26} + \underbrace{\frac{\$6.132}{(1.08)^3}}_{\text{Year 3}\ \to\ \$4.87} = \text{Present value of 3-year investment}$$

$$\$5.88 + \$5.26 + \$4.87 = \$15.81 \text{ per pound of daily base}$$

In this procedure, we are trying to find out how much money we can afford to invest now and come out even on that investment in three years. In effect, by investing \$15.81 per pound of daily base today, we will break even with the (\$6.132) (3 years) or \$18.40 return we will get from the base milk in three years. The eight percent cost of capital compounded over the three-year period reduces the amount that we can afford to invest rather substantially.

I have outlined an approach to base valuation. In an actual market situation, buyers and sellers of base probably won't attempt to delineate the factors and assumptions as we have done. However, it is a good bet that the value bases take on won't be too far from the $15.81 estimate that we have made. Actual values in our Ohio markets would be under the $15.81 estimate, largely because something less than 100 percent certainty will be attached to the valuation procedure.

As for the future for supply management in the milk industry, I believe five observations are in order:

1. We are in the third year of milk production increases in the U. S. (1970, 71, and 72), and it appears that production will continue to increase for at least two more years.

2. Unless the current strength in commercial sales of milk and dairy products is a longer run phenomenon than we now recognize, surpluses of dairy products moving to the CCC will increase.

3. There is every likelihood that after several years of producer price increases, a plateau in producer prices will be reached in 1973.

4. The net effect of increasing production, stable demand, growing surpluses, and a static price situation will lead to a lot of discussion about base plans.

5. If history is any guide to industry-wide acceptance of supply management, it is not likely that any comprehensive base plan will be implemented.

ADJUSTMENTS NEEDED IN THE N.M.P.F. SUPPLY MANAGEMENT PROPOSED PROGRAM

Robert Brewer
President
Cincinnati Cooperative Milk Sales Association

I do not want to imply, in this discussion, that I am negative to a supply management program. Quite the contrary, I am in favor of such a program. Basically, the proposed program can add more order and system to our manner of milk marketing. The purpose of a supply management program is to tailor, somewhat, total production to meet the demands of the commercial market plus domestic and foreign government program needs. And in so doing, the program itself creates conditions conducive to satisfactory prices for dairy farmers.

Dairy Situation -- First Seven Months of 1972:

Milk production up 1-1/2 percent (on a daily average basis) in 1972 so far, compared to the first seven months of 1971, is estimated in total for 1972 at 120.5 billion pounds. This is up approximately two billion pounds this year.

Commercial disappearance of milk in all dairy products through July of this year increased by 2-1/2 percent. If that rate of increase holds for the year the increase in commercial needs would be 2.7 billion pounds this year. Total commercial disappearance of milk in 1972 would then be 111.7 billion pounds up from 109.0 billion in 1971.

USDA purchases of dairy products are down so far this year. Estimates are that total purchases will be down one billion pounds from the 7.3 billion pounds of milk equivalent in 1971.

Milk prices received by all farmers are up 2-1/2 percent from last year. Dairy farm cash receipts are estimated at $7.1 billion in 1972, up from $6.8 in 1971.

Prices received by farmers for all milk is 16 cents per cwt. over this time last year, but 28 cents less in parity equivalency. Four points of parity have been lost to higher costs to farmers.

Dairy imports this year will exceed the 1.3 billion pounds in 1971. Exports of dairy products are down because C.C.C. butter exports ceased. World butter output is up, along with milk production.

But to make a point, regardless of conditions at any one point in time, I believe a Supply Management Program should be implemented for the benefit of dairy farmers.

My assignment is to note needed adjustments in the proposal now under consideration:

1. The first provision of the NMPF proposal needing further consideration is the section of the proposed program providing for the determination of History of Marketings.

"A history of marketings would be determined for each dairy farmer or for two or more farmers producing milk from the same production facility."

I suggest that in the landlord-tenant arrangement, the history of marketings and the subsequent quota should be established for the farm rather than individuals. I believe this would be fair to all concerned. The tenant would have vested interests in 50 percent of the quota and would sell his 50 percent of the quota and leave it with the farm upon leaving such farm. Otherwise, it would create disorder. Such is the case with tobacco bases relative to tenant and landlord arrangements.

2. Quota for each Dairy Farmer:

   The Secretary determines a marketing percentage by dividing the estimated national quota by the total of the histories of marketings.

   This marketing percentage is then applied to each dairy farmer's history of marketings without exception to establish the individual quotas.

   I suggest that this provision needs further study as to application to local market needs.

   As it now stands, unnecessary costs, both to producers and handlers, would be created. This is particularly true in high utilization markets. And more and more, it appears that even a 65 or 70 percent Class I utilization may not represent an adequate supply.

3. Assessment on Deliveries in Excess of Quota:

   Irrespective of method of payment, a farmer would receive a net $2.00 per cwt. for over quota milk under the NMPF proposal.

   Inequities exist in this provision in that cost of production varies by region; therefore, at $2.00 per cwt., producers in areas of high production and lower costs would experience less costs to produce over quota milk than producers in areas having higher production costs. And again, this procedure would tend to shorten supplies in areas having higher demands for fluid milk sales.

4. A supply management program that would perform on behalf of producer interests wanting to hold production in line with demand and administered by the government for a consistent length of time would further negate the influence of government support prices. If the need for surplus purchases is removed, the need, or at least most of the need, for support prices is removed. This is one more reason why it will be a difficult task to implement the program.

This program as proposed can be voted out, after being accepted; therefore, the need for the support price program must not be jeopardized.

THE IMPACT OF THE PROPOSED INDIANA CLASS I BASE PLAN ON OHIO MILK SHEDS AND MARKETS

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The title of the subject the program committee assigned to me can be discussed in a very few words. I could merely say it isn't going to have an impact on Ohio milk sheds and markets. But human nature being what it is, someone would say, "Why?", and that is what I will discuss with you during the next few minutes.

Perhaps a little background information about Class I base plans would be helpful. The Food and Agriculture Act of 1965 authorized Class I base plans for the first time in the history of Federal milk orders, amending the Agricultural Marketing Agreement Act of 1937, and it was to be effective through December 31, 1969.

The Puget Sound marketing area in the state of Washington had been working on a Class I base provision for their market and lobbied for the legislation to establish Class I base plans under Federal orders. They thought this would remedy their surplus problem. Their Class I utilization at the time was approximately 45-50 percent. A hearing and referendum was held and a Class I base plan became effective in the Puget Sound order in September, 1967.

A hearing was held on the Southeastern Florida order. A recommended decision was rendered by the Department denying a Class I base plan because no surplus situation existed. Thus, it appears to me that USDA's interpretation of Congress' intent was to deny Class I base plans to markets that did not have a surplus problem.

The Agriculture Act of 1970 continued authorization for Class I base plans until December 31, 1973, and provided that Class I base plans in effect prior to December 3, 1973, could be extended beyond that date, but not past December 31, 1976. The Agriculture Act of 1970 also made several changes in the Class I base plan, including the requirement that a producer's base would automatically be updated each year. Also, a plant becoming regulated by Federal orders with a Class I base plan would automatically provide bases, the same as producers already shipping under the order and, of course, several other changes. But these are two of the provisions of the Class I base plan that had the most effect on the decision relative to the proposed Class I base plan for Indiana Order 49.

Following the history-making events that took place when the President and Secretary of Agriculture were announcing the parity prices of milk in March, 1971, for the 71-72 year, considerable interest developed in the states west of Ohio, particularly where there had been large coop mergers (A.M.P.I.-MID AM) in holding a hearing on a Class I base plan. The theory was advanced that this would be a means of controlling production and preserve the markets from outside pressure if a large surplus of milk developed in the heavy producing states.

Producers generally do not like controls and the Chicago Order 30, Central Illinois Order 50, and Southern Illinois Order 32 soon cooled to the idea of a Class I base plan for their orders. The coops in the Indiana Order 49 continued to have discussions. The idea of a Class I base plan was promoted in producer meetings of certain cooperatives. In our own meetings, we attempted to discuss the provisions of the Class I base plan without trying to influence the producers one way or the other, and the only actual plan in operation that had experience that we could cite was the Puget Sound Area, where production continued to increase faster than sales. Therefore, the Class I utilization percentage was continuing to drop.

It finally was decided that a proposal should be submitted to USDA for the Indiana Area. The Hoosier Milk Marketing Agency, Inc., a federated group of coops supplying milk in the Indiana area, submitted a proposal to the Department for consideration. They replied, and I quote, "Several aspects of the plan are questionable under the statute or appear ambiguous" and invited us to Washington to discuss the proposals. We met with several members of the Department, and I think I am safe in saying that the Department does not like Class I base plans, and maybe rightly so. I don't think it is for me to judge: However, making judgements is a favorite pasttime of most of us. Following the meeting with the Department, it was decided that to change the proposals to conform with the Department's interpretations and have a hearing that any recommended decision the Department would issue would surely be voted down in a referendum. This is the one provision of Federal orders that requires an individual producer vote; that is to say one man - one vote, and the coops couldn't block vote their membership. After our final meeting on proposals, one of the coops had a membership meeting in the Indiana Area and took a secret ballot after explaining the proposals and the vote was approximately 3 to 2 against asking for a hearing on the proposals.

Now here are some of the other reasons that we felt it would not be in the best interest of the producers supplying milk to Order 49, to attempt to put a Class I base plan into that order. Producers supplying a plant that became regulated under an order with a Class I base plan would be provided bases immediately, determined on their past deliveries. If this were a pool distributing plant that became regulated because of its sales, it would bring with it both producer milk and Class I sales. It would, therefore, depend on the plant's utilization as to whether it improved or hurt the producers already in the market. However, a supply plant could attach itself to the market and add sizeable amounts of producer milk to the market without any offsetting Class I sales and the producer would be given a base immediately according to his production history. In another situation, a producer that had been shipping to a non-pool plant would be assigned a production history effective the first day of the second month following the month in which he began delivery of producer milk to a pool plant. This would be done on the same basis as if he had been a producer under the order and his deliveries to the non-pool plant had been deliveries to the pool plant under which he started shipping.

The proposals provided that bases be allocated on the basis of 120 percent of the Class I sales during August through December. This total, divided by the total production history base would be the Class I base percentage and the new bases would become effective February 1 of each year. As you can see, if production increases faster than Class I sales or if additional producer milk moves into and attaches itself to the market, the Class I base percentage will decrease.

Gordon Laughlin, talking before the Great Lakes - Southern Milk annual meeting, stated that the Puget Sound Class I base percentage was 65.2 percent in 1971, dropped to 57.07 percent in 1972, and he was estimating that it would be 50 percent or less for 1973. The Class I base plan in the Puget Sound area has resulted in a real race for base. A producer with 1000 pounds daily production history in 1971 would have had a base of 652 pounds. By 1973, if his production had remained at the 1000 pounds daily, his base would be only 500 pounds. Looking at it the other way, he would have had to increase his daily production to 1304 pounds to maintain the 652 pounds base he had in 1971, approximately 30 percent.

Another problem we thought we would encounter would be the shifting of producers between the markets if Indiana was the only order in the Mid-west to have a Class I base plan. This is one aspect that could have a serious impact on the Ohio markets. Producers living along the Indiana-Ohio line, the Indiana-Michigan, Indiana-Kentucky, or Indiana-Illinois line would probably have access to another Federal order market and he could sell his base and move to one of the other Federal order markets. For example, it would be possible to sell the base if Indiana had a Class I base plan and start shipping to the Ohio Valley market and get the blend price immediately. This probably would be comparable on an annual basis to the price he received under the base plan; but it could vary widely depending on the month, as the Class I utilization percentage between the two orders is relatively the same - Ohio, 1971 - 68 percent Class I and Indiana, 1971 - 70 percent Class I utilization. For any increase in his production, he would receive the blend price under the Ohio Valley Order and the same would be true for the Kentucky or Illinois orders. While under a Class I base plan, if he had additional production throughout the year, he would receive the excess on order Class III price for the additional production until a new base was determined the following February. If it had been possible that the producers would have voted a Class I base plan into the Indiana order, it would have meant that the order would have been an island surrounded by Federal orders paying a blend price.

As we pointed out, a producer could sell his base and it would be like a pension or retirement plan to someone who had access to another market. He could sell his base and start shipping to a surrounding Federal order market that did not have a Class I base plan. This, I believe, would be one of the real dangers to the continued orderly marketing of producer milk because of the overlapping of routes moving to the Federal order markets surrounding the Indiana market.

The seasonal pricing plan (sometimes referred to as the Louisville Plan) in most of the Federal order markets, including the Ohio order, would be eliminated in an Order with a Class I base plan. This would result in a misalignment of prices during the four take-out months and the four pay-back months. This would result in producer dissatisfaction and certainly would not be conducive to orderly marketing of milk if milk was produced for a market with a Class I base plan by a producer and his neighbor was producing for a market operating with the Louisville Plan and blend price.

In summary, the decision of Hoosier Milk Marketing Agency, Inc., to table the Class I base plan proposals for the Indiana Order indefinitely was the decision that had to be made, as it became evident that the plan would not manage production or protect the market from outside milk and it could penalize some producers while benefiting others. Any program designed to manage production and protect producer income certainly must represent more than one percent of the total United States production. Production of producer milk in the Indiana Order was 1.8 billion pounds, while the national production was approximately 119 billion.

Certainly, the producers producing the milk and the coops marketing the milk in the Western part of Ohio are going to have a more orderly market because the Indiana marketing area does not have a Class I base plan.

REGULATORY MILK PRICING -- PROBLEMS AND ISSUES

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It is easier to talk about milk pricing problems and issues than it is to talk about their solution. I rationalize talking mostly about problems by keeping in mind that defining a problem is a first step to solving a problem.

The Milk Pricing Problem

No one needs to be told that the dairy industry has a pricing problem. The problem is not easy to define. It has many dimensions:

1. It is a problem of cycles of production and prices. These cycles draw productive resources into an industry when prices are high and force them out when prices are low. They are revealed in the peak production, surplus conditions, and low prices experienced in the early 1960's and the sharp declines in production, relative deficit conditions, and relatively higher prices, experienced in the middle to late 1960's. These production price cycles result, at least in part, from improper or lagged price adjustment and/or overreaction to changes in economic conditions in the milk industry. Resource misallocation results as production and processing resources move into the industry during periods of expansion and are forced out during periods of contraction.

   The development of a pricing system which provides early sensitivity to factors such as present and future costs of producing milk, alternative farm and off-farm opportunities, and the effects of prices, substitutes, income, and population growth on demand may provide opportunities to anticipate changes in the industry supply-demand balance.

   Even if such early sensitivity exists, some question whether producers change production patterns in response to relatively small changes which result from manipulation of support and Federal order prices. They argue that the price shock is generally not great enough to change producer plans and that at blend or support price levels it is still profitable to increase production.

   Proponents of this position argue for National base plans which provide the flexibility to price marginal surplus production at a level which is in the economist's jargon below the marginal cost of production. The effect on production, they argue, would be more direct and instantaneous -- higher culling, closer evaluation of concentrate feeding rates, and closer assessment of expansion plans. These arguments of the proponents of base plans are at least partially valid. The controversy is over other effects -- the impact on efficiency, regional patterns of production, capitalization barriers to entry, and ineffectiveness of existing base plans, political and administrative feasibility of the base plan proposals, and conflicts in values over the extent to which the dairy industry should be controlled by Government .

2. The competitive manufacturing milk pricing base for the milk industry -- the Minnesota-Wisconsin price series -- will need to be replaced as conversion to Grade A milk occurs. The Minnesota-Wisconsin price series has been a prime mover of Federal order prices. Conversion to Grade A will eventually mean that compatitive pay prices for manufacturing milk will no longer exist. The conclusion, of course, is that most converted Grade A production will become associated with a Federal order because of its normally higher blend or producer pay price.

   There are also implications for the support program. Its prime focus has been to support the price level for manufacturing grade milk. Assuming the support program is retained when conversion takes place, this focus necessarily changes to one of achieving the parity price objective for all milk. Yet the price for all milk is affected by both Federal order and support prices. Class I prices could take on new significance in terms of achieving the parity price objective. In any case, movement toward a single grade of milk will likely require that there be closer coordination between the support and Federal order programs in terms of the most appropriate way to attain the support objective at prices which are adequate but do not produce excessive milk supplies.

3. The milk pricing problem is also a problem of competition. It is a problem of competition both among cooperatives and between cooperatives and the non-member. In part, it is a problem of variation in services performed for handlers and improper pricing of those services relative to the costs of performing them. Improper pricing results <u>both</u> from a lack of knowledge of the cost of providing specific services, and from an inability to recover costs because of competition. The competitive pricing problem also results from the fact that the benefits of cooperatives cannot be limited to cooperative members. Or, put another way, the costs of cooperatives are not shared in relation to the benefits. I will have more to say about the dimensions of the solution to this problem later.

   The competitive problem is more complex today because of competition among uses for milk. A highly desirable 12 percent increase in demand for cheese this year has resulted in cheese plants being able to bid milk away from butter-powder plants. The result has been keen competition among uses for milk and low margins for butter-powder operations. While most people view this as a temporary phenomena, it has created a short-term pricing problem.

4. The current pricing problem is also a legal problem. The legal problem may be viewed as having two dimensions. From a legislative standpoint statutory limits exist on what the Secretary can feasibly do to deal with issues in milk pricing. The Agricultural Act of 1949 requires that the support price for manufacturing milk be established between 75 and 90 percent of parity -- no higher and no lower. Class I base plan legislation provides that the over-base price be no lower than the surplus Class price. Non-price Federal orders are not presently provided for in legislation. These are but a few examples of legal limits on the Secretary's authority to deal with

pricing problems. To remove them, the legislation itself must be modified.

The second dimension of the legal problem is an anti-trust problem. The current anti-trust suits raise several questions with respect to the practices cooperatives can utilize to deal with pricing problems -- particularly as they concern other cooperatives, the non-member, and the independent hauler. Until these questions are resolved, cooperatives' ability to deal with certain pricing problems will be uncertain.

With this by way of background on the forces which are requiring a change in milk pricing procedures and some limits on them, let me now discuss with you some specific aspects of these problems as they relate to their pricing implications. I would like to deal with three specific areas: Class I pricing, surplus pricing, and service charges or payments.

Class I Pricing

One alternative in this area is an economic formula. It requires the development of factors which will effect changes in milk supply and demand. As you know, there are a host of variables that affect milk supply and demand. Economists have met with only limited success in developing equations which accurately forecast either milk supply or milk demand. We have tried to develop this type of formula and you will be interested in the types of problems we are running into. They include: what variables to include, how to express these variables, how much weight to give each variable, what base period to use, how to deal with lags involved, and how sensitive to make the formula, to mention a few.

One of the early problems you run into in developing an economic formula is that economically and statistically sound estimating equations invariably yield milk prices which are highly sensitive to changes in milk supply or demand. Thus, when milk supplies increase, say one percent, prices fall drastically -- four or five percent. Now this should not be surprising to anyone -- we have known for some time that both the demand and supply of milk are highly inelastic. This is precisely one of the major reasons we have the Federal order and support price program -- to lend price and income stability to the industry. The question is importantly one of how these price swings can be moderated but yet maintain a relative balance between supply and demand -- given the fact and assuming we are willing to continue to purchase some residuals under the support program.

One advantage of an economic formula method of pricing is that it hopefully could provide anticipatory insight into forces at work affecting supply and demand. Hopefully, it would make possible price adjustments prior to the development of sizable shortages or surpluses and thereby eliminate the need for larger adjustments later. Even though it may not be possible to develop a supply-demand equilibrium formula as the sole method of establishing Class I prices; such a formula could be used as an important adjunct in establishing prices through some type of hearing process where all pertinent information was presented as the basis for the Secretary's reaching a decision as to changes needed in Class I prices. I'll say a little more about this approach later.

Another alternative is some modification of the type of formula supported by the National Milk Producers Federation. This formula included 12 factors divided into four groups. The four factor groups were chosen to reflect: (1) the ability and willingness of consumers to buy; (2) cost factors in producing milk; (3) alternative opportunities; and (4) manufactured dairy product prices. The Department felt that this formula divorced the establishment of Class I prices from the rest of the dairy economy to too great an extent. Particularly, the lack of sufficient coordination with actions under the price support program was a concern. Furthermore, there was little indication that many of the individual formula factors had any logically consistent economic relationship to the price of milk.

Another alternative would be some type of product price formula as a basic mover for Class I prices. Butter-powder formulas and cheese milk formulas have been used in the industry and in Federal milk orders for a long time. They involve the use of market prices, yields, and processing costs in estimating the value of milk for manufacturing. They are estimates of what plants can afford to pay (as contrasted to the Minnesota-Wisconsin price which reflects prices reported paid).

Two main problems exist in developing product price formulas: (1) developing adequate measures of prices for manufactured products, and (2) determining appropriate make allowances.

Workable product price formulas will require better indicators of product prices than presently exist. Central markets for butter and cheese are too thin to serve as a base for formula prices. If they are to be utilized, their competitive base will need to be broadened and closer supervision of the market will be required. An alternative to relying on exchange prices is to utilize actual prices received for products by a sample of processors.

Because of the wide variations in plant efficiencies and problems of cost allocation, it is difficult to arrive at a "make allowance" that is representative. Our experience has been that evidence presented at hearings usually is so conflicting as to provide an unsatisfactory basis for determining make allowances. That is not to say that this is an insurmountable problem, but suggests the need for developing more complete data on processing costs under varying conditions.

Another alternative means of establishing Class I prices would be to regularly (say once a year) hold a national hearing to consider changes needed in Class I prices and possibly also the dairy price support level. Such a hearing would provide a forum at which all interested parties would have the opportunity to present evidence on the current and prospective supply-demand situation.

Such a procedure would probably make it necessary for the Government to take an active role in the presentation of evidence bearing on changes needed in Class I and price support levels. The Government witnesses could be cross-examined and various industry representatives could present detailed information and analysis as to changes they think are needed in milk prices. Economic type formulas such as that developed by the National Milk Producers Federation study group or supply-demand equilibrium models such as I discussed earlier could be presented in evidence and might provide helpful guidance as to needed changes.

Use of the hearing approach would, in effect, recognize that the forces affecting milk supply and demand are so complex and diverse as to make it impossible to rely upon any one mechanistic measure to adjust prices. If this approach were to be adopted, it might be desirable to prescribe specific factors which must be considered in arriving at any decision as to price changes. Also, provision might be made to provide some basic anchor which prices might not depart from by more than a specified amount. If the price support decision was to be considered at the same time as the Class I price decision, the means for coordination of the two programs would be provided. This coordination might well serve as the anchor needed in any scheme of modifying Class I prices.

One of the drawbacks of the hearing procedure for establishing Class I prices might be that the period following the annual hearing might become a rallying point for various producer and other groups to descend on Washington with view to applying all the political pressure that could be mustered to influence the decision.

Surplus Pricing

Surplus pricing is probably the most difficult and most controversial area the Department faces in milk pricing. Serious problems arise if the surplus price is established at levels which are too high or too low.

Volumes of surplus milk handled vary substantially between markets and between individual handlers. In addition, there are wide differences among and within markets in the variability of the amount of surplus milk processed from day to day and seasonally. This influences surplus processing costs. Separate and apart from the size and variability of the surplus, there are differences in plant efficiencies among and within markets. Also, there are differences among and within markets in the products in which surplus milk is utilized. These products, at times, have considerably different use values. All of these factors make it difficult to arrive at a single price which will be acceptable to all parties.

The Department has chosen wherever possible to rely upon competitive pay prices for two reasons: (1) the difficulty in obtaining adequate information at public hearings as to make allowances; and (2) the use of competitive pay prices assures that surplus prices in milk orders are in line with prices paid for manufacturing grade milk by unregulated manufacturing plants.

As competitive pay prices disappear, it is apparent that other methods of establishing surplus prices will have to be used. Product price formulas are the most apparent alternative. But as I said before, better information on product prices and costs are needed if product price formulas are to be satisfactory. Some method of automatically updating cost allowances in such formulas is being explored.

Surplus pricing does not end with the method for establishing the prices. There are some very knotty issues that are at the heart of the controversy over surplus pricing. These include:

(1) Whether the same surplus prices should be used in all markets and, if not, the basis for establishing different levels in different areas;

(2) The level of efficiency to which surplus prices should be keyed if the same surplus price is used in all areas;

(3) The number of surplus classes to establish and which products to include in which class.

Cooperatives in many areas tell us they are losing money on the handling of surplus milk; particularly, we hear this from operators of butter-powder plants. In other areas, we hear of cooperatives being able to sell milk for surplus use at premiums of 30-35 cents over the Minnesota-Wisconsin price.

To a certain extent the existence of such premiums and butter-powder plant losses results from competition exerted on the raw milk price by an unusually strong cheese market. When cheese manufacturing capacity adjusts to this expanding market, relief from this situation can be anticipated.

There is, however, no question that there are variations in the cost of handling surplus milk among markets. Such differences are, in my opinion, importantly due to differences in costs of performing the balancing functions in markets of different size, in different locations, and with different fluid utilization. The real question is whether surplus prices should be adjusted to reflect such differences! Experience in Federal orders indicates that important economic distortions can result from tampering with Class II prices on a market-by-market basis.

My inclination, as a matter of economic philosophy, is to attack the problem in the most direct way possible. If the problem is one of differences in costs associated with balancing, then a recognition of such costs should be included in a service charge pricing strategy for the market. Variations in costs of handling surplus milk should then be covered through service charges on Class I milk.

The only question is whether this should be done in the public sector within Federal orders or in the private sector by cooperatives.

Service Charges

Our discussion of surplus pricing has led us to the question of whether service charges should be integrated into the Federal order pricing system. This is a complex question and I will speak of it only philosophically. I like to distinguish between three kinds of services performed for a market: (1) those services performed as a necessary aspect of administering a Federal order market -- testimony or other activities related to the regulatory environment, research on milk marketing problems, educational activities, and maybe promotion, (2) those services associated with performing the balancing function, and (3) those specific services rendered handlers in the procurement of quality milk supplies at specific times.

There are two main problems encountered with service charges: (1) identifying what services are being performed by whom, and who is receiving the benefits, and (2) putting a price tag on the value of services performed. With respect to the farmer, it must be remembered that cooperatives are not the only ones who provide services to a market, and some services provided by the cooperative are provided mainly to the benefit of cooperative members.

The problem of putting a price tag on services is even more complex. Hearings have not been a very good vehicle for establishing the appropriate level of make allowances. Can one expect more in the case of service charges?

In my view, there is a more important philosophical question of the extent to which we want to turn the milk industry into a public utility as opposed to a more open, competitive system. We have, wisely in my opinion, had a policy minimizing the degree of price regulation. The system has had its problems, but it has worked reasonably well -- particularly when compared with price and rate regulatory counterparts such as resale price regulation for dairy products, regulation of transportation, power, and communication. We have maintained a high degree of industry productivity, efficiency, reasonable price and income stability with a minimum of sacrifice of freedom. How far do you go in rate regulation before you hamstring an industry? I do not profess to know the answer to this question. There is probably good justification for certain service charges, but there is also the very legitimate question of how far you go and how you get there.